In the Supreme Court

OF THE

United States

OCTOBER TERM, 1977

No. 77-1859

JERE N. HELFAT,
Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit

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Petitioner Jere N. Helfat prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in this case on February 6, 1978.

OPINIONS BELOW

The memorandum decision of the District Court, filed March 26, 1976, is appended hereto as Appendix A, pages 1 through 3. The opinion of the Court

of Appeals is appended hereto as Appendix B, pages 4 through 23.

JURISDICTION

The Court of Appeals entered judgment on February 6, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

QUESTIONS PRESENTED

The major question presented is:

Shall the standard established by this Court[1] to control review of an exercise of discretion in a Federal District Court to issue or not issue an injunction against prospective violation of federal securities laws, i.e., that such exercise shall be affirmed unless the government demonstrates that there is no reasonable basis for the decision, be modified to extend the power of the reviewing court to substitute its judgment for that of the District Court?

A second question here presented, which may be resolved in this case,[2] is:

Is an injunction against prospective violations of the securities laws an appropriate remedy in a situation where the past violation by the person against whom the injunction is sought was due to mere negligence only?

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[1]In *United States v. W. T. Grant*, 345 U.S. 629 (1953), and elsewhere.

[2]The basis for this qualifying language is set forth at p. 20, *infra*.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The applicable constitutional and statutory materials are set out in Appendix C, pages 24 through 31.

STATEMENT OF THE CASE

A. Discovery and Reporting of the Fraud.

On Friday, August 3, 1973, the executive leadership of Koracorp Industries, Inc. uncovered a major fraud being perpetrated by certain officers and employees of a subsidiary corporation, which significantly distorted Koracorp's financial statement. The situation came to light when Louis Philip Weil (herein "Weil") in effect confessed that he and a number of associates had manipulated the accounts receivable of Koratec Communications, Inc. in such a manner that over five million dollars shown on the books were largely uncollectible and in part nonexistent. The admission was made at a meeting called by Koracorp's president, petitioner Jere N. Helfat (herein "petitioner" or "Helfat"), to determine the reason for this slow-moving accumulation of receivables, and to explore possible ways to expedite collection. Appendix B, pp. 6-7.

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[3]This petition will cite to the opinions below for facts, with comment as necessary. We intend to designate for certification and transmittal, pursuant to Supreme Court Rule 21.1, a limited part of the record, including the complaint, an S.E.C. investigative transcript dealing with Jere N. Helfat (herein "Helfat Transcript"), and two affidavits of petitioner, dated February 12, 1976 (herein "Helfat Affidavit") and March 12, 1976 (herein "Helfat Supplemental Affidavit"). These documents will also be cited.

On the following Monday, this alarming disclosure made by Weil was reviewed by petitioner with other corporate officers and legal counsel. It was then determined that the acts of Weil and his group might involve violations of the Securities Exchange Act of 1934 and other federal securities laws. Pursuant to this conclusion, Koracorp (acting on petitioner's direction) fully and completely disclosed to the Securities and Exchange Commission (herein the "S.E.C.") and the New York and Pacific Coast Stock Exchanges the full particulars of the discovery on August 7th. At the same time, and again on the recommendation of petitioner, Koracorp launched its own investigation of the irregularities which had come to its attention. Helfat Affidavit; C.R. 180-182.

Koracorp Industries, Inc. is a large and highly diversified Delaware corporation whose stock is publicly traded on the New York and Pacific Coast Stock Exchanges. Koratec Communications, Inc. was one of several subsidiaries administered under the umbrella of Koratec Unicenter, directed by Arthur F. Cunningham (herein "Cunningham"), a Vice-President of Koracorp, Inc. Koratec Communications, Inc. (herein "K.C.I.") enjoyed, however, a large degree of autonomy in its actions. Appendix B, pp. 5-7. Helfat, in fact, had virtually no contact with Weil. Helfat Transcript, pp. 25-26.

B. S.E.C. Response.

Upon receipt of the information of receivables irregularities from the Koracorp management, the S.E.C. suspended all trading in Koracorp securities.

This suspension was lifted in early 1974. (Appendix B, p. 7). By the time the trading reopened, petitioner (Weil's remote supervisor) had resigned as president of Koracorp pursuant to a request of the board of directors. Weil also resigned after request, and Cunningham was ousted as vice-president by the same body.

After his resignation on August 24, 1973, Helfat remained for a period of time with the corporation as a special consultant to the chairman of the board.

After an intense two-year investigation, the S.E.C. filed (under date of November 26, 1975) a complaint (Northern District of California No. 75 2515 SW) against Weil, and others associated with him, charging culpability in the fraudulent receivables debacle. In this action,[4] the S.E.C. also complained against petitioner, Cunningham, Koracorp itself, and Arthur Andersen & Co., a public accounting firm. Although the complaint taints them all with broad conclusionary averments[5] of sundry wrongdoing in its intro-

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[4]The S.E.C. invoked the jurisdiction of the District Court pursuant to Sections 20(b) and 22(a) of the Securities Act of 1933, and Sections 21(d), 21(e) and 27 of the Securities Exchange Act of 1934. Complaint, Appendix A, ¶4-5.

[5]An example of this type of allegation is the language in paragraph 25 of the complaint asserting that *as of its date* (November 26, 1975), petitioner was engaged in security "schemes, artifices and devices to defraud." The S.E.C. has never made, however, a serious effort to prove improper securities activities on the part of petitioner after his resignation in August, 1973. Indeed, as the Court of Appeal opinion notes (Appendix B, p. 10), the S.E.C. agreed "that after the collapse of KCI and the exposure of the fraud, violations ceased". Even by liberal federal pleading standards, this pleading *as fact* statements the S.E.C. clearly knew to be false at the time made, must be characterized as irresponsible and destructive overreaching.

ductory parts, it is clear from the subsequent, more particular, allegations and the course of conduct of the S.E.C. since the complaint was instituted that the essence of the Commission's charge against petitioner was not that he was directly involved as a principal in the fraud, but rather that he (1) failed to disclose to the public when he knew or should have known of Weil's scheme the particulars thereof, and (2) covered up the manipulations to his personal profit.[6] The sole relief sought against petitioner was the imposition of an injunction against further violations of the United States securities laws.[7] After instituting the action, the S.E.C. continued its investigation through formal discovery devices.

C. Summary Judgment Motions.

In early 1976, motions for summary judgment were filed by various defendants.[8]

In response to these motions, the S.E.C. presented evidence that Weil was the "chief architect of the fraud" and that he and his cohorts caused to be placed and carried upon K.C.I.'s books "millions of dollars of uncollectibles and sometimes wholly ficti-

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[6]Since K.C.I. was a subsidiary of Koracorp whose financial statement was incorporated in its parent corporation, the manipulations of the Weil group caused the profits of Koracorp to be overstated. Helfat, like others in management, received as a part of his compensation package a bonus tied into corporate profit.

[7]The complaint made specific reference to the Securities Act of 1933, as amended, Sections 10(b) and 13(a) of the Securities Exchange Act of 1934, as amended, and Rules 10b-5 and 13a-1 promulgated thereunder.

[8]For purposes of this motion only, petitioner conceded negligence.

tious, accounts receivable." Appendix B, p. 5. Evidence was also presented showing that Weil received kickbacks from parties with whom K.C.I. did business.[9]

The evidence marshalled and presented at the summary judgment hearing showed that Koracorp management first became aware that there might be a problem with K.C.I. receivables in 1971, when Arthur Andersen & Co. inquired as to whether these receivables were being liquidated with sufficient expedition. In response thereto, petitioner ordered an investigation conducted by Ronald McClellan, an outside director of Koracorp and a financial consultant, of these receivables. Following this investigation, McClellan reported that these receivables were good, valid and collectible. Helfat Transcript, p. 32.

As noted in the Court of Appeals opinion (Appendix B, p. 7, ll. 1-3), a further internal investigation was ordered by petitioner in May of 1973, when the situation had not improved in spite of the clean bill of health which had been given in the 1972 McClellan report.

The precise language in the opinion is significant; while it states that by the May 1973 date petitioner was "aware of the receivables debacle" (Appendix B, p. 70), but it fails to note that what he was aware of at that time was merely a large and apparently

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[9]Weil never denied that he received these monies, but chose to characterize them differently than did the S.E.C., and assert that they were properly received.

indigestible accumulation of accounts receivable. Neither of the opinions below state, and the S.E.C. found no evidence to demonstrate, that petitioner was aware of any fraud, manipulative impropriety, or violation of the securities laws, prior to Weil's confession on August 3, 1973.

After careful study of the materials submitted in support of and in opposition to petitioner's summary judgment motion, the United States District Court granted summary judgment to petitioner and certain of the defendants.[10] in a memorandum decision dated March 26, 1976. In so ruling the Court exercised the discretion vested in it by law and held that the S.E.C. had not demonstrated a threat of subsequent violations to justify a prospective injunction. Judge Spencer Williams issued a memorandum decision explaining the reasons for his decision. The specific language of that decision is illuminating. After stating that the S.E.C. had failed to bring forth "hard facts" to demonstrate the need for an injunction, the Court went one specific and significant step further and noted that "no facts have been *alleged* upon which the court could conclude that there is any expectation of future violations, let alone a reasonable one." Appendix A, p. 2. (Emphasis added).[11]

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[10]Weil was not one of the beneficiaries of this ruling, but was later granted summary judgment following a separate hearing.

[11]It is apparent here that Judge Williams was referring to the particular and specific allegations in the complaint, and not broad-brush boilerplate such as that noted in footnote 5, *supra*.

D. Appellate Review.

Appeal was taken by the S.E.C. against the summary judgments granted in favor of petitioner and other defendants, and consolidated with the summary judgment motion subsequently granted in favor of Weil, and his group. On February 6, 1978, the Court of Appeals for the Ninth Circuit (opinion by the Honorable Shirley Hufstedler, joined by the Honorable Russell E. Smith, chief judge for the United States District Court of Montana, and the Honorable James M. Carter) reversed all of the summary judgments except that granted to Arthur Andersen. Justice Carter wrote a concurring opinion. Thereafter, timely petitions for reconsideration were filed by Koracorp and petitioner Jere N. Helfat. Through an order filed May 24, 1978, the Court of Appeals denied both petitions.

ARGUMENT IN SUPPORT OF ALLOWANCE OF WRIT

I. IN SEVERELY LIMITING THE DISCRETION OF A DISTRICT COURT TO ISSUE OR WITHHOLD AN INJUNCTION AGAINST PROSPECTIVE VIOLATIONS OF THE FEDERAL SECURITIES LAWS, THE NINTH CIRCUIT HAS RESOLVED A FEDERAL QUESTION IN A MANNER IN MARKED CONTRAST WITH APPLICABLE DECISIONS OF THIS COURT.

A. The Broad Equitable Discretion Vested in a District Court, As Defined By This Court.

The standards governing the discretion of a district court judge in granting or refusing to grant an injunction against future violations of law have been clearly delineated by this Court. A leading case, re-

lied on by both petitioner and the S.E.C., and cited in both opinions below, is *Hecht Co. v. Bowles,* 321 U.S. 321 (1944).

In *Hecht,* as here, high corporate officers were brought into court by a federal agency to restrain them from future violations of a government legislative and regulatory scheme (the Emergency Price Control Act). After concluding that the "mistakes . . . were all made in good faith and without intent to violate the regulations" (321 U.S. at 525), this Honorable Court analyzed the nature of the injunctive enforcement remedy. A distillation of that analysis, insofar as here pertinent, is that this remedy did not spring full blown from the head of the federal bureaucracy, but rather came into modern governmental law "with a background of several hundred years of history" (321 U.S. at 329) in equity practice. This Court discussed the discretion vested in chancellors in equity to tailor relief to particular situations, without being unduly stymied by rigid precedent:

> "The historic injunctive process was designed to deter, not to punish. The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mould each decree to the necessities of the particular case. Flexibility rather than rigidity has distinguished it." 321 U.S. at 329.

Another case which was central to the briefing and argument at both levels below was *United States v. W. T. Grant,* 345 U.S. 629 (1953). The statutory context of that case differed from the instant case (the

provisions of the Clayton Act of 1974 which prohibited interlocking directorates), but the relief sought was identical. In language strongly reminiscent of the language in Judge Williams' opinion quoted on page 8, *supra,* the District Court which ruled initially in *W. T. Grant* concluded that there was not "the slightest threat that the defendants will attempt any future activity in violation of §8 . . ." 345 U.S. at 631. In rejecting the contention that the District Court judge had abused its discretion, this Court again discussed the nature and utility of the injunctive remedy. Reaffirming that "the purpose of injunctions is to prevent future violations" (345 U.S. at 633), this Court made clear that an injunction may lie in particular circumstances without a showing of past wrongs, or be rejected in other circumstances when a showing of past wrongs is present, since the *sine qua non* is a reasonable threat of *future* infractions. The Court stated "[*t*]*he chancellor's decision is based on all the circumstances; his discretion is necessarily broad and a strong showing of abuse must be made to reverse it.*" (Emphasis added.) In setting forth pertinent criteria the court stated them to be "the bona fides of the expressed intent to comply, the effectiveness of the discontinuance and, in some cases, the character of the past violations." 345 U.S. at 633.

In *United States v. W. T. Grant,* in marked contrast to this case, the defendant had refused repeated administrative efforts to terminate the wrongful acts. In view of this and other facts, this Court suggested

that were it sitting as a trial court, it might have been persuaded to issue an injunction. Nonetheless, the Court articulated its hesitation to substitute its discretion for that of the district court judge, and affirmed the District Court. The opinion then set forth the burden placed upon the government agency seeking to undo a district court decision denying an injunction:

> "[T]he government *must* demonstrate that there was *no reasonable basis* for the District Judge's decision." 345 U.S. at 634. (Emphasis added.)

Neither the historical background of the vestiture of chancellors in equity with broad discretion nor the value thereof to the administration of justice, need be explored in detail at this point. This utility, however, is menaced by the decision of the Ninth Circuit in this case, which is irreconcilable with the holdings of this Court, and insensitive to the sound policies underlying these holdings.

B. The Equitable Standard Vested in the District Court, As Defined By the Ninth Circuit.

The United States Court of Appeals for the Ninth Circuit showed none of the reticence to overturn a district court judge in this case that graced the consideration of this Court in *United States v. W. T. Grant*. It required no strong showing by the government; indeed, it required no showing of substance *at all*. Early in the opinion (Appendix B, pp. 11-13) the Court of Appeals improperly shifted the burden of persuasion on petitioner and the other defendants.

While giving lip service to the proposition that the controlling factor should be the threat of future violations (Opinion, Appendix B, p. 11), it nevertheless concentrated solely on one part of the three-pronged formula above quoted, and (if the language of this Court is to be taken literally) the least significant of these factors, i.e., past violations.

While some parts of the opinion, considered in isolation, would appear to belie this statement, it seems clear when the opinion is ingested as a whole that the Court of Appeals lost sight of the fact that it was reviewing a summary judgment granted on the limited issue of whether there were sound grounds to prospectively enjoin petitioner and the other defendants from future violations of securities laws, and not considering the quite different question whether they were culpable for negligent or intentional misconduct in the past. Judge Williams did not pronounce the defendants clean; he merely ruled on the appropriateness of one particular remedy.

However, it may be noted that even if the motion before the court had truly been what the court erroneously perceived it as being, i.e., a question of whether petitioner acted with scienter, affirmance would still have been mandated. The record simply does not support anything beyond the conceded negligence. It is significant that the opinion of neither the District Court nor the Court of Appeals contains any recitation of specific facts which were *proven* by the S.E.C. to support its allegations that petitioner was

guilty of fraud, bad faith, aiding and abetting, etc.[12] At the beginning of the lawsuit, the S.E.C. made serious allegations against petitioner. After the intensive intervening discovery,[13] it was still relying on such allegations. The S.E.C. contentions against this petitioner (as distinguished from some of the other defendants) rest on remote chronological relationship, unlikely inference, and improbable supposition. Neither opinion suggests that the allegations against Jere N. Helfat were *factually* substantiated.[14]

It is apparent from the majority opinion (see Appendix B, particularly pages 14-16) that the Ninth Circuit was primarily (and quite understandably) concerned by the fact that financial manipulations of a highly dubious nature had gone on within the corporate structure of Koracorp, and yet each of the parties charged with active wrongdoing or complicity had successfully resisted the S.E.C.'s attempt to impose injunctions. This result is not, upon reflection, as disturbing as it might initially seem,

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[12]It is apparent that there is a problem of citation and proof in connection with this assertion. The only way this Court can verify the *absence* of sufficient evidence in the record to justify reversal is to examine the entire, extensive record (thousands of pages). This sheer bulk of the record makes this impractical at this juncture. Accordingly, petitioner simply challenges the S.E.C., in its reply to this petition, to bring to the attention of this Court actual hard evidence of scienter or cognizant, deliberate fraud in the record which supports its charges against petitioner.

[13]The fact that there has been ample opportunity for discovery and that the S.E.C. has been unable to uncover any actual evidence of any affirmative wrongdoing by Helfat is in itself a compelling argument for the District Court's ruling. See *Willmar Poultry Co. v. Morton-Norwich Products, Inc.*, 520 F.2d 289, 293 (8th Cir. 1975).

[14]This is considered more fully on pp. 23-26, *infra*.

since the question before the District Court was not whether past violations had occurred, but whether, considering all applicable circumstances and facts, a threat of future violations of such magnitude existed to justify the remedy sought.

The court, in effect, sent the matter back for a sorting-out process, pursuant to which the sheep might be separated from the goats, or (more precisely) the violators from the non-violators. What seems to have escaped the notice of the court is that this sorting out process had already been in large measure accomplished by the S.E.C. through its internal processes, and by all parties through discovery and production of documents for the summary judgment proceeding. As the Court of Appeals noted, "[a]ccording to evidence presented by the S.E.C., Weil was the chief architect of the fraud." Opinion, Appendix B, p. 5. The S.E.C. had taken the same position in its briefs and memoranda.[15]

While the efficient administration of justice is furthered generally by consolidations of cases which present common or closely related questions of law, it is apparent that the interests of petitioner in this case were ill-served by consolidating his appeal with that of Weil, the actual miscreant. It is respectfully submitted that consideration in the aggregate of the charges against all the defendants could not have helped but distort the perspective of the Court.

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[15]For example, it refers to Weil as "the principal architect of the fraud" in both its brief filed in October 1976 (p. 4), and its brief filed in February 1977 (p. 5).

Not only is the majority Ninth Circuit decision insensible to the equities of the case, it is an invitation to further and extended judicial proceedings that will be totally futile.

The Memorandum Decision filed March 26, 1978, fails to analyze and appreciate the thrust and content of the opinion of the District Court.[16] As noted in the statement of facts, a careful analysis of the wording of that document leads inevitably to the conclusion that it stated, alternatively:

(1) the S.E.C. had not proven facts that would support an expectation of further violations of the securities laws justifying imposition of an injunction, and *further*

(2) "no facts have been *alleged*" which would support such issuance, i.e., that even if the S.E.C. had proven its entire theory, the relief sought would still be inappropriate.

If the District Court is to be taken on its word, the outcome of the extended hearing is a foregone conclusion. Even if the S.E.C. succeeds in producing evidence to support its most extravagant allegations (which it will not), the Court will reach the same result as it earlier reached, and the case will be back before the appellate court in the same posture several months hence.

Thus, in spite of (1) the lack of *any* evidence demonstrating cognizant impropriety, (2) petitioner's role

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[16]The concurring opinion of Justice Carter demonstrates his awareness of the problem. See p. 29, *infra*, for a consideration of that opinion.

in exposing and reporting the problem, (3) the dearth of any evidence (or even claim) that petitioner had violated the securities laws (or any other laws) prior to the onset of the situation which is the subject matter of this action, and (4) the specific finding of no threat whatsoever of future violations, the Ninth Circuit held that the S.E.C. had made the strong showing of abuse necessary to reverse the trial court's ruling, and that there was "no reasonable basis" for its decision. This holding is, quite simply, inexplicable.

C. Not Only Is the Ninth Circuit Opinion Inconsistent With Controlling Decisions of This Court, It Is Internally Inconsistent With Itself.

After ignoring in a strikingly cavalier manner the principles enumerated in *United States v. W. T. Grant, supra,* in that part of the opinion dealing with petitioner and certain other defendants (Appendix B, pp. 10-16), the court rediscovered these principles in its consideration of the summary judgment motion granted in favor of Arthur Andersen & Co. (Appendix B, pp. 16-22). There, it recognized the broad discretion vested in the district court acting as a chancellor in equity. It correctly noted that past violations do not mandate the issuance of an injunction and that "[t]he critical issue is that there is a reasonable likelihood that the wrong would be repeated. The district court has a significant degree of latitude in making that determination." Opinion, Appendix B, page 21. It says, in fact, all the right things. It is soundly reasoned and attractively written. One could not wish for a more ringing reaffirma-

tion of the principles that control this type of proceeding as articulated by this Honorable Court. However, this restoration of the mantle of discretion to the district judge which had been earlier wrested from his shoulders does not cure the prior error. It merely makes the second part of the opinion completely inconsistent with what preceded it.[17] It was in fact an abuse of its powers and discretion for the Ninth Circuit to hold, on the one hand, that the trial court properly exercised its discretion in granting the summary judgment motion of Arthur Andersen & Co. and at the same time reversing the summary judgment in favor of petitioner, when such factual similarity is present.

There are some rather obvious differences between the *formal* posture of petitioner and Arthur Andersen & Co. before the Court. Petitioner was a part of the corporation's internal management team, and Arthur Andersen was an outside observer. The *real* posture of petitioner and Arthur Andersen in this case, however, is in substance comparable. Each was remote from the actual wrongdoing. Each, according to the S.E.C., saw or should have seen red flags which should have prompted an in-depth investigation which, we are informed, would have promptly exposed the miscreants.[18] Each conceded negligence for purposes of argument at the time of the summary judgment

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[17]This inconsistency was the subject of the petition for rehearing filed by Koracorp.

[18]The fact the earlier investigations did not unearth the scheme is overlooked in this contention.

motions.[19] Each was charged by the S.E.C. with wrongdoing *beyond* negligence. In each instance (as the opinions of the courts below confirm by both what they contain and what they do not contain) the S.E.C. was unable to substantiate its charges of intentional wrongdoing with supportive hard evidence, in spite of the years of discovery which antedated the summary judgment motions.[20]

II. THIS COURT SHOULD FINALLY SETTLE THE QUESTION OF WHETHER THE IMPOSITION OF AN INJUNCTION AGAINST PROSPECTIVE VIOLATIONS OF SECURITIES LAWS AND REGULATIONS IS APPROPRIATE WHERE PAST VIOLATIONS HAVE NOT BEEN INTENTIONAL, BUT MERELY NEGLIGENT. THIS CASE PRESENTS A VEHICLE FOR SUCH RESOLUTION.

A. Introduction; Nature of Issue Presented.

Point I addresses the presence of a decision of a court of appeal resolving "a federal question in a way in conflict with applicable decisions of this Court" (Rule 19(b), Supreme Court Rules) in this case.

In this point, that part of Rule 19(b) describing the presence of "an important question of federal law

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[19]There is one difference here, and that is that Andersen and the Commission virtually adopted each other's factual statements. While the S.E.C. did not adopt Helfat's statement of facts in its motion for summary judgment, it failed to refute any of the material facts stated therein with real evidence. The difference between (a) not attempting to controvert a statement of facts, and (b) attempting but totally failing to controvert facts, is not, it is submitted, significant in the context of this summary judgment motion and appellate review.

[20]As to charges against Arthur Andersen in addition to negligence, see Appendix B, pages 17-20.

which has not been, but should be, settled by this court" is involved.

As noted in that part of this petition delineating the questions presented for review, there is a caveat here. The bases thereof are two-fold:

1) This Court may, if it desires, avoid resolution of this question and decide the case (as did the Court of Appeals in its review of the Arthur Andersen decision) on the more limited ground that the District Court acted within its discretion;

2) It must be stated, in candor, that the S.E.C. will almost certainly dispute petitioner's assertion that this issue is squarely presented in this case.

While this dispute is clearly something which lends itself to detailed consideration in the brief on the merits provided for in Supreme Court Rule 41, a concise summary here seems inevitable and is the subject of Point II.B., *infra.*

It is one of the worst-kept secrets of the securities bar that the S.E.C. is becoming increasingly enamored of the injunctive remedy. We do not address the intrinsic worth of this enforcement device in cases of deliberate malfeasance, where it might arguably be remedial. On the other hand, singleminded pursuant of an injunction, looking neither to the right nor to the left, where no cognizant wrongdoing was involved and where the injunction almost by definition will have no deterrent effect whatsoever, is a flagrant waste of court time and taxpayer money. Decisional law is not clear as to when pursuit of this remedy

is and when it is not permissible. This case will give the Court an opportunity to draw meaningful guidelines.

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) held that in the absence of scienter, a private civil damage suit will not lie under Section 10b of the Securities Exchange Act of 1934 and Rule 10b-5.[21] While it did not specifically address the propriety of injunctive relief where only negligence is present, the same logical and policy grounds on which *Ernst & Ernst v. Hochfelder* is grounded suggest that such relief is inappropriate. Some courts have adopted this extension. See, e.g., *Securities and Exchange Commission v. Bausch & Lomb, Inc.,* 420 F.Supp. 1226 (S.D. New York 1976).

The same rationale which quickened *Ernst & Ernst v. Hochfelder* surfaced again recently in *Santa Fe Industries, Inc. v. Green,* ..... U.S. ....., 97 Sup.Ct. 1292 (1977). The interpretation given to §10(b) and Rule 10b-5 in that case cannot be reconciled with the position the S.E.C. has taken in the case at bar.

In spite of these cases, and the sheer illogic of formal prospective restraint from negligent acts, the S.E.C. took the position in this case (as it has in many others) that injunction relief is an appropriate remedy where simple negligence is presented. Appendix B, p. 20.

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[21]The fact that *Ernst & Ernst* dealt with an outside auditor, rather than a corporate office remote from the wrongdoing, does not seem significant in policy terms.

B. The "Evidence" Marshalled by the S.E.C. in Opposition to Petitioner's Summary Judgment Motion Was Insufficient to Meet the Standards of Rule 56(e), Federal Rules of Civil Procedure and Consists Solely of Naked Supposition, Innuendo Founded on Chronology and the Unsupported Allegations in the Complaint.

1. The Standard.

Rule 56(e) Federal Rules of Civil Procedure provides:

> "(e) When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, *must set forth specific facts* showing that there is a genuine issue for trial. If he does not so respond, summary jugment, if appropriate, shall be entered against him." (Emphasis added.)

A recent federal district court opinion described the responsibility of a party opposing summary judgment under Rule 56(e) to produce "detailed and precise"[22] facts as follows:

> ". . . He must respond with substantial and concrete particulars to establish that there is a genuine issue for trial; general assertions are inadequate. [citations omitted]" *Upper W. Fork River Watershed v. Corps of Engineers,* 414 F. Supp. 908, 914 (D.W. Va. 1976).

As this Court stated in a similar frame of reference in *United States v. W. T. Grant Co., supra*: "[S]ome-

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[22]*Liberty Leasing Co. v. Hillsum Sales Corporation,* 380 F.2d 1013 (5th Cir. 1967).

thing more [is required] than the mere possibility which serves to keep the case live." (345 U.S. 633).

2. The "Evidence" Offered by the S.E.C.

The "facts" on which the S.E.C. relied in resisting summary judgment lend themselves to classification into somewhat imprecise, but pragmatically useful, categories. They are as follows:

(1) Circumstances of physical and temporal proximity from which scienter or affirmative wrongdoing is simply assumed.[23] In place of the "substantial and concrete particulars [required] to established that there is a genuine issue for trial,"[24] the S.E.C. makes its case "only on suspicion and on a gossamer inference drawn from the mere sequence of events."[25]

(2) Allegation of cause-and-effect relationship between petitioner's bonus compensation and the inflated receivables from which guilt is inferred.[26] Each of

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[23]The cardinal argument in this category is that since Weil and his group were under petitioner's ultimate control, petitioner just *must* have known that the receivables were spurious. There is no affirmative evidence whatsoever that prior to August 3, 1973, petitioner knew that these receivables were the result of fraudulent financial manipulations.

[24]*Upper W. Fork River Watershed v. Corps of Engineers*, 414 F.Supp. 908, 914 (D.W. Va. 1976).

[25]*Waldron v. British Petroleum Co.*, 38 F.R.D. 170 (S.D.N.Y. 1965), aff'd *sub nom. First National Bank of Arizona v. Cities Service Co.*, 391 U.S. 253 (1968).

[26]The main accusation here seems to be that petitioner benefited from the defalcation since the misdeeds inflated the profit of Koracorp and petitioner's bonus was based in part upon such profit. The inherently unbelievability of a contention that petitioner would risk (1) his whole financial future, (2) his reputation, (3) the future and financial stability of the corporation over which he presided and in whose well-being he had a continuing interest, (4) criminal prosecution and (5) the institution

the contentions (and they are no more than that) extrapolated from the record "by its nature is so incredible as to be unacceptable by reasonable minds, . . .".[27]

(3) Evidence and conjecture relating to the question of whether petitioner was negligent. Since negligence was conceded, this material was redundant, irrelevant and affirmatively confusing.

(4) Bare allegations, with no attempt to present buttressing data.

(5) A challenge to credibility, i.e., Helfat says such-and-such, we don't believe him, and therefore there is an issue of fact. The profession of disbelief itself becomes a substitution for evidence. This seemed

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of civil actions which might seek damages in astronomic sums, for a few additional bonus dollars, does not seem to bother the S.E.C. in the slightest.

Nor does the S.E.C. seem concerned that the logical basis of this argument is inconsistent with the logical basis of the alternative argument that petitioner should have discovered the fraud earlier. According to that argument, (encompassed in the first of the five categories delineated in the text), petitioner should have discovered the wrongdoing because the magnitude of the problem made it apparent what was going on. By this argument, in contrast, it is suggested the defalcation was so sophisticated and difficult to detect that petitioner had confidence it would *not* be uncovered, and acted accordingly.

The S.E.C.'s inconsistent and ultimately irrational position on this point tends to cloud a distinction that is clear on the record as to petitioner's knowledge of the receivables problem prior to and after August 3, 1973. Before Weil's admission, Helfat regarded the high receivables as a cash flow problem of considerable magnitude, and addressed it in the way that one would expect such a problem to be addressed by top corporate management. However, it was only after August 3 that petitioner knew (or indeed had any reason to suspect) that deliberate wrongdoing was involved.

[27] *Molinos de Puerto Rico, Inc. v. Sheridan Towing Co.*, 62 F.R.D. 172 (D. Puerto Rico 1973).

to make an impression on the Court of Appeals, and thereto compels more than passing mention.

The material in the Court of Appeals opinion addressing the importance of an evidentiary hearing to establish credibility (Appendix B, pp. 15-16) articulates sound law in the abstract, but law which is not applicable to this situation. It is axiomatic that weighing credibility is a major role of a trier of fact. However, it comes into play *only* when *evidence* conflicts with *evidence.* A challenge to evidence by a protestation of disbelief, or by an unsupported inconsistent accusation, does not negate the evidence (unless such evidence is inherently unbelievable), or raise a question of fact requiring resolution by a trier of fact. The essence of a summary judgment proceeding (as opposed to a motion to dismiss for failure to state a claim for relief, or such state-court procedures as the demurrer) is that it is *evidentiary.* Sworn affidavits of fact and other relevant documents are rebutted with sworn affidavits and other documents, making possible summary adjudication on the question of whether *factual* controversy exists. This is what Rule 56(e) contemplates, and this is where the S.E.C. presentation was abjectly inadequate.

None of the categories above described encompass real factual evidence of the type a party resisting summary judgment must present. The S.E.C. presented no real evidence as to scienter and had none to present. Each of the circumstances on which it relied as a foundation for an inference of possible wrongdoing lends itself reasonably and naturally to

an alternative explanation offered, totally inconsistent with the S.E.C.'s position, and readily comprehensible in terms of business management.

When, after extensive discovery including depositions of the movant-party, the plaintiff places his reliance on the "substantial hope that he can produce evidence at the trial,"[28] the trial court is justified in concluding that a trial "would develop no further facts which would in any way alter [the court's] decision."[29] That is the situation here.

C. While This Court Might Sidestep This Issue and Resolve the Case on Other Grounds, The Issue is Framed in This Case and Should Be Decided By This Court.

In the majority opinion (Appendix B, pp. 20-21), the Court of Appeals refers to the question of the appropriateness of injunctive relief "against an independent auditor who was guilty of simple negligence" as "specifically left open" in *Ernst & Ernst v. Hochfelder, supra.* This is encompassed within the larger question here framed, which is as to the appropriateness of this remedy in a federal securities law context in the event of simple negligence by any party.

This Court could clearly avoid resolution of this issue and decide the case on the ground the District Court acted within its discretion under all facts and circumstances involved, just as the Court of Appeals

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[28]*Chapman v. Rudd Paint & Varnish Co.*, 409 F.2d 635, 643 (9th Cir. 1969).

[29]*United States Jaycees v. San Francisco Junior Chamber of Commerce*, 354 F.Supp. 61, 69 (N.D. Cal. 1972), *Peter J. Allen Corp. v. California Furniture Shops, Ltd.*, 344 F.Supp. 437, 441 (N.D. Cal. 1972).

decided the Arthur Andersen appeal. However, it is strongly urged that this avoidance would be against the interests of the American bench and bar (however laudable the principle of judicial reticence might be in the abstract) for reasons that will hereinafter be made clear.

D. Issuance of an Injunction Has No Curative Dimension Where Negligence Only Is Involved.

Petitioner has consistently taken the position throughout these proceedings, and will assertively contend in his brief hereinafter filed in the event this petition is granted, that the imposition of an injunction against a party whose sole culpability is negligence is without value, and in fact affirmatively harmful.[30]

It is not contended that the securities laws may not be negligently infracted. It is suggested only that the injunction remedy is extraordinarily ill-suited for this situation.

The S.E.C.'s major responsibility, as charged by the Congress and the people of this country, is to act as a watchdog over the securities industry to police it against those who would misuse or manipulate securities or investors wrongfully to their own profit. In cases of repeated cognizant violations of law, an injunction—either alone or in tandem with other

[30]The term "negligence" as used herein does not include those states of mind or behavior known in the law as recklessness or gross, wilful or wanton negligence. These connote cognizant wrongdoing or utter abandonment of reasonable behavior. These present a special situation, in which each case might be best addressed on an *ad hoc* basis. This situation is not presented in this case.

remedies—can serve a useful purpose. It is illogical, however, to purport to enjoin individuals or organizations which have allegedly violated securities law through negligence from such future violations, since they did not deliberately err in the first place. One might just as well enjoin an individual from forgetting his wife's birthday. If human error could be eliminated by injunction we would indeed be at the very gates of paradise. An injunction based on or prohibiting negligence would have no deterrent effect. Its imposition would be a meaningless charade from the point of view of securities violations, and would be punitive in nature, seriously impairing the reputation and ability to earn a livelihood of a person who is guilty of no deliberate wrongdoing.

III. DEFINITIVE ADDRESS OF THE ISSUES FRAMED WOULD EFFECT A SUBSTANTIAL SAVING IN JUDICIAL TIME AND ENERGY, AND SERVE THE ADMINISTRATION OF JUSTICE.

A. Reaffirmation of the Principle of District Court Discretion Will Facilitate Focused Appellate Review.

In its erroneous opinion, the Ninth Circuit Court of Appeals has clouded the clear direction this Court gave in *Hecht Co. v. Bowles, supra, United States v. W. T. Grant Co., supra,* and other cases. Under the Ninth Circuit opinion, the S.E.C. gets virtually a *de novo* hearing, with the Circuit Court independently exercising its judgment, rather than the limited review to determine the existence or non-existence of a reasonable basis for the District Court's ruling, as this Court has repeatedly directed. This decision

will complicate proceedings before, and increase the burden upon, all courts reviewing a denial or granting of an injunction in cases involving alleged violations of not only federal securities laws, but a plethora of other statutory and regulatory provisions.

In his concurring opinion, Justice Carter recognized the very real threat to valuable judicial time in this and comparable cases particularly where (as here) it appears that the district court will exercise its discretion as it did before and deny injunctive relief again following the hearing for which the case is remanded.[31]

B. A Particularly Significant Dispensation of Judicial Time and Energy Will Result If This Court Rules That An Injunction Does Not Lie Where Negligence Alone Is Involved.

In view of the demands which are increasingly made upon federal courts and officials, it seems difficult to justify the expenditure of hundreds of hours of lawyer and court time in pursuit of a form of pseudo-relief without prospective deterrent effect. For the

[31]However sound Judge Carter's prospective analysis of the case might be, and however appropriate his sensitivity to the realities of federal practice, the specific course of resolution proposed by him is hardly feasible. He suggests that the individual defendants admit, for purposes of the summary judgment motion only, all of the specific *charges* set forth in the complaint as restated in the majority opinion (Appendix B, pp. 22-23) and then permit the judge to re-enter the summary judgment. While this course is not without pragmatic appeal, it is quite understandable that a lay person such as petitioner, not schooled in the intricacies of the law, might not be easily persuaded to go into court and confess, even for a limited purpose, to an imposing variety of misdeeds of which he is actually innocent. This would further a belief (already asserted by some critics) that our courts are too often engaged in playing intricate games rather than in a real search for truth.

reasons heretofore stated, this is the intolerable situation that presents itself when the S.E.C. seeks injunctive relief against parties who have been merely negligent.

This extravagantly inappropriate remedy is being repeatedly and resolutely pursued, and such pursuit will cease only when this Court makes it unprofitable.

CONCLUSION

For all the foregoing reasons this Court should grant a writ of certiorari to review the decision below.

Dated, San Francisco, California,
June 28, 1978.

Respectfully submitted,
BURTON J. GOLDSTEIN
RALPH GOLUB
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(Appendices Follow)

Appendix A

In the United States District Court
for the Northern District of California

No. C-75-2515 SW

Securities and Exchange Commission,
Plaintiff,

vs.

Koracorp Industries, Inc., et al.,
Defendants.

[Filed March 26, 1976]

MEMORANDUM

The parties in this action appeared before this court on Friday, March 19, 1976, on motions for summary judgment made by defendants Koracorp, Koratek, Arthur Andersen & Co., Arthur Cunningham and Jere Helfat. This court ruled at that time, based upon all of the papers filed in this matter and upon the oral arguments then presented to the court, that the summary judgments should all be granted. The other motions pending were not reached.

The parties asked for a written memorandum in this matter embodying the court's reasons for its decision.

To procure an injunction for prospective relief against a party charged with violations of the securi-

ties laws, the Securities Exchange Commission has a heavy burden to sustain:

> The SEC concedes that it has the "burden to present a strong prima facie case of violation." It may well have done so, but that is not enough. There must also be a showing that there exists a "reasonable expectation of further violations." *(SEC v. Keller Industries,* 342 F.Supp. 654, 660 (S.D.N.Y. 1972).)

In attempting to meet its burden of showing a reasonable expectation of further violations, the SEC seemed more concerned with creating a factual pattern which would thwart the motion for summary judgment than establishing hard facts on which such an expectation could be asserted. The purported "facts in dispute" here related primarily to dissatisfactions the SEC apparently entertains with the degree to which corrections and disclosures, made by the parties in the closing months of 1973 and early months of 1974, were adequate disclosures of what occurred in 1973 and earlier. The actual facts not in dispute clearly show efforts by all of the parties defendant in this lawsuit to eradicate the effects of the past, alleged, violations of the securities laws. There is no showing whatsoever of any violations by these parties in the last 18 months, and no facts have been alleged upon which the court could conclude there is any expectation of further violations, let alone a reasonable one.

An injunction in an SEC action is a drastic remedy, *(Securities Exchange Commission v. Franklin Atlas Corp.,* 171 F.Supp. 711, 718 (S.D.N.Y. 1959),) his-

torically designed to deter, not to punish. *Hecht Co. v. Bowles,* 321 U.S. 321, 329 (1944). Injunctions in SEC actions are "subject to principles of equitable discretion." *Hecht Co. v. Bowles,* 321 U.S. 321, 327 (1944). In the absence of a showing that further violations are to be reasonably expected, this court does not believe any injunction is appropriate. Despite SEC arguments to the contrary, what it seeks is more than a mere prophylactic related to the specific facts of the case. The broad, all-encompassing injunction sought here against any conceivable future violations carries the strong inference that the court believes the defendants *would* violate the law but for the court's intercession, an inference this court believes to be too heavy to place on these defendants on as inadequate a showing as has been made here.

Therefore,

IT IS HEREBY ORDERED that summary judgment in favor of defendants Koracorp, Koratek, Arthur Andersen & Co., Arthur Cunningham and Jere Helfat be granted.

Dated: 3-26-76

/s/ Spencer Williams
Spencer Williams
United States District Judge

Appendix B

United States Court of Appeals
for the Ninth Circuit

Nos. 76-2547
76-2964

Securities and Exchange Commission,
Plaintiff-Appellant,

vs.

Koracorp Industries, Inc., et al.,
Defendants-Appellees.

[Filed Feb. 6, 1978]

Appeal from the United States District Court
for the Northern District of California

OPINION

Before: CARTER and HUFSTEDLER, Circuit Judges, and SMITH,* District Judge.

HUFSTEDLER, Circuit Judge:

The Securities and Exchange Commission ("SEC") brought these two suits to obtain injunctions preventing the defendants from committing future violations of the anti-fraud and reporting provisions of the fed-

*Honorable Russell E. Smith, Chief Judge, United States District Court, District of Montana, sitting by designation.

eral securities laws. The district judge granted defendants' motion for summary judgment. The SEC appeals, contending that since material issues of fact are in dispute, the district court abused its discretion in granting summary judgment. We agree with the SEC with respect to all of the defendants except Arthur Andersen & Co. ("Andersen"). With respect to Andersen, we conclude that there was no genuine dispute as to any material fact, summary judgment was permissible, and the district court acted within the scope of its discretion in denying the injunctive relief sought.

Defendant Koracorp Industries, Inc. ("Koracorp") is a corporation, engaged in a number of business enterprises, whose common stock is publicly traded on the New York and Pacific Coast Stock Exchanges. Defendant Koratec Communications, Inc. ("KCI") was a wholly-owned subsidiary of Koracorp whose principal business was the publication of a controlled-circulation advertising magazine, "Homemaking with a Flair" ("Flair"), which was used for direct mail promotion. Defendant Weil was the president of KCI, defendant Cunningham was a vice president and director of Koracorp, and defendant Helfat was chief executive officer and president of Koracorp.

According to evidence presented by the SEC, Weil was the chief architect of the fraud. Weil's compensation depended in part upon the volume of KCI's business. Weil was able to increase his compensation by causing to be placed and carried on KCI's books millions of dollars of uncollectible and sometimes wholly fictitious, accounts receivable. The SEC claimed that

Weil also used these overbooked receivables to conceal kickbacks that were paid to him by corporations with which KCI did business. KCI's financial statements were consolidated with Koracorp's. When KCI's stack of receivables collapsed, Koracorp had to reverse over five million dollars which had been improperly shown as income on its books.

Defendant Andersen, Koracorp's accounting firm, first became aware of irregularities in KCI's accounts receivable while preparing its audit of Koracorp's 1970 financial statement. Andersen received a poor response from selected KCI customers with whom it attempted to confirm receivable. When its examination of contracts and collections failed adequately to support receivables in the amounts recorded, Andersen insisted that KCI's 1970 reserves for uncollectible accounts be increased, and it furnished Koracorp with critical comments concerning the inadequate documentation of transcations at KCI. In its 1971 and 1972 audits, Andersen again attempted to obtain confirmation for KCI's receivables from its customers, and repeatedly cautioned Koracorp about the deficient control procedures and the inadequate written documentation of transactions at KCI. The SEC produced evidence that the principals of KCI, with the assistance, or at least the passive neglect, of one or more of the principals of Koracorp, tried to cover up the overbooked receivables of KCI. By early May, 1973, the accounts receivable of KCI had grown to almost six million dollars, of which five million dollars was long past due or had never been

billed. Cunningham and Helfat were aware of the receivables debacle, and Helfat directed that an internal investigation be conducted.

Following that investigation, Weil, in early August, 1973, admitted to Helfat that almost all of KCI's 1972 accounts receivable from advertising were uncollectible. Koracorp directed Andersen to conduct a special investigation into the accounts receivable situation at KCI. Andersen learned that substantially all of the 1972 confirmed accounts were now disavowed by customers and that the information obtained during the 1972 audit had been misrepresented. On August 7, Koracorp informed the New York and Pacific Coast Stock Exchanges and the SEC, and on August 8, the SEC suspended all trading in Koracorp's securities. On September 10, 1973, Andersen withdrew its auditor's report on Koracorp's 1972 financial statement. The original 1972 financial statement reported earnings per share of $0.27. After restatement in early 1974, by which time five million dollars of improperly stated income of KCI had been reversed, the 1972 revised financial statement showed a loss of $1.02 per share. Trading in Koracorp's securities was not permitted to be resumed until early 1974.

Meanwhile, at a special Koracorp board of directors' meeting on August 7, 1973, the board was informed by Cunningham of KCI's overstated accounts receivable and by Helfat of Weil's offer to purchase Flair. The board agreed to the sale of Flair to Weil, contingent upon his resignation as president of KCI.

On August 24, 1973, the Koracorp board of directors requested Helfat's resignation as president and director of Koracorp, but retained him as a special consultant at full salary with all fringe benefits. The board also removed Cunningham from his position as vice president, after he refused to resign. Cunningham remained as a director of Koracorp until May, 1975. Both Cunningham and Helfat received bonuses based upon Koracorp's original 1972 earnings of $0.27 per share.

After a two-year investigation, the SEC filed these complaints in November, 1975. The SEC alleged that Weil was directly responsible for overbooking accounts receivable and for diverting funds from KCI by collecting illegal kickbacks from Flair's customers. These kickbacks were made to corporations that he and his wife owned, defendants Western Gateway Corp., Verve, Inc., Associated Graphics, Inc., and Allison Production Affiliates, Inc. The SEC also alleged that Helfat and Cunningham knew about the fraud and participated in the cover-up by failing to disclose to the Koracorp board and to the public their knowledge of the spurious accounts receivable, the illegal kickbacks to Weil, and the other irregularities in KCI.

The SEC contended that Andersen was negligent in its audits of Koracorp and in its failure to uncover the KCI scheme. The SEC did not claim that Andersen did any affirmative acts in connection with violations of the securities laws by the principals of

Koracorp and KCI, nor did it contend that Andersen had any actual knowledge of the fraud or of the reporting irregularities.

The SEC sought injunctions against the ten individual and corporate defendants to prevent their participating in any future violations of the federal securities laws. At the initial hearing before the district court, the court accepted suggestions by the defendants that the nature of the defendants' activities in connection with the violations was not significant in deciding whether injunctions should issue. The court accordingly restricted the inquiry into the conduct of the parties after the exposure of the fraud in August, 1973. The court also limited discovery to post-August, 1973, matters, "so that they [the defendants] can use that as a basis for motions for dismissal or summary judgment."

The SEC and Andersen both filed motions for summary judgment. The remaining defendants also accepted the district court's invitation by filing motions for summary judgment. We reverse summary judgment in favor of the defendants, other than Andersen, because the district court improperly allocated the burden of persuasion on motion for summary judgment, and triable issues of material fact foreclosed judgment in those defendants' favor. We affirm summary judgment for Andersen because no material issues of fact remained in dispute, and the district court did not abuse its discretion in denying injunctive relief against Andersen.

I

Everyone agrees that the manipulation of KCI and Koracorp, the cover-up activities in which these corporations were engaged, and the diversion of funds from KCI in the form of "commissions" or "kick-back" involved serious violations of the securities laws conducted over a period of several years. Everyone also agrees that, after the collapse of KCI and the exposure of the fraud, violations ceased. No violations had occurred for about eighteen months before the district court granted summary judgment to the defendants. Finally, everyone agrees that the evidence presented to the district court concerning the nature and extent of the participation of the various defendants in the violations was sharply conflicting.

Weil, Helfat, Cunningham, Koracorp, and KCI convinced the district court that all of the disputed facts were immaterial because each of them had conceded, solely for the purpose of the summary judgment, that each was potentially liable in some unidentified respect for the violations. The nature of these concessions is aptly described in one of the defendants' briefs: "[T]he moving Defendants conceded, in the court below, the existence of conflicts in the evidence concerning culpability in 1973." In addition to these "admissions," the defendants offered evidence tending to prove reformation, and in some instances changed circumstances, making it unlikely that some of the individuals would re-engage in securities transactions.

The primary purpose of injunctive relief against violators of the federal securities laws is to deter future violations, not to punish the violators. (*Hecht Co. v. Bowles* (1944) 321 U.S. 321, 329.) The central issue, therefore, is whether as a matter of law the district court could conclude that "there was no significant threat of future violation." (*United States v. W. T. Grant Co.* (1953) 345 U.S. 629, 635.) If the nature and extent of the culpability of the several defendants is a material fact, summary judgment must be reversed because culpability was hotly disputed.

The burden was upon the KCI and Koracorp defendants, as the parties moving for summary judgment, clearly to establish the non-existence of any genuine issue of fa[illegible] material to judgment in their favor. (6 Pt. 2 J. Moore, *Federal Practice* ¶ 56.15 [4], p. 56-511.) In granting these defendants' motions for summary judgment, the district court erroneously reversed the burden, stating, "[i]n attempting to meet its burden of showing a reasonable expectation of further violations, the SEC seemed more concerned with creating a factual pattern which would thwart the motion for summary judgment than establishing hard facts on which such an expectation could be asserted."

The district court could not grant summary judgment unless the defendants were entitled to judgment as a matter of law. "[T]he moving party has the burden of clearly establishing the lack of any triable

issue, although the opposing party would at trial have the burden of proof on a particular issue. It is not the function of the trial court at the summary judgment hearing to resolve any genuine factual issue, including credibility; and for the purpose of ruling on the motion all factual inferences are to be taken against the moving party and in favor of the opposing party, and the appellate court will do likewise in reviewing the trial court's grant of summary judgment. Discretion plays no real role in the grant of summary judgment: the grant of summary judgment must be proper under the above principles or the grant is subject to reversal." (6 Pt. 2 J. Moore, *Federal Practice, supra,* ¶ 56.15[8], p. 56-643.)

An inference arises from illegal past conduct that future violations may occur. (*SEC v. Culpepper* (2d Cir. 1959) 270 F.2d 241; *SEC v. Keller* (7th Cir. 1963), 323 F.2d 397, 402.) The fact that illegal conduct has ceased does not foreclose injunctive relief. (*United States v. W. T. Grant Co., supra,* 345 U.S. at 633; *Los Angeles Trust Deed & Mortgage Exchange v. SEC* (9th Cir. 1960) 285 F.2d 162; *SEC v. Manor Nursing Centers, Inc.* (2d Cir. 1972) 458 F.2d 1082.) Promises of reformation and acts of contrition are relevant in deciding whether an injunction shall issue, but, neither is conclusive or even necessarily persuasive, especially if no evidence of remorse surfaces until the violator is caught. (*United States v. Parke, Davis & Co.* (1960) 362 U.S. 29, 48 ("A trial court's wide discretion in fashioning remedies is not to be exercised to deny relief altogether by lightly

inferring an abandonment of the unlawful activities from a cessation which seems timed to anticipate suit.")))[1] Moreover, courts must be particularly skeptical about attaching any significance to contrition under protest. (*E.g., SEC v. Manor Nursing Centers, Inc., supra,* 458 F.2d at 1101.) The changed circumstances of the violator are also relevant in determining whether an injunction shall issue, but neither changing jobs nor deterioration of health, in and of itself, or in combination with the cessation of illegal activities and proclaimed reformation, provides a complete defense to an injunction suit. (*E.g., SEC v. Pearson* (10th Cir. 1970) 426 F.2d 1339.)[2]

When the burden of proof is properly allocated to the defendants and the inferences are drawn against them, it is evident that the uncontroverted facts failed to disclose defenses sufficient to defeat the SEC's suits as a matter of law. Therefore, we turn to the question whether the disputed facts presented

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[1]We are reminded of the wry observation of the Seventh Circuit in rejecting the contention of some securities law violators that no injunction was necessary because they had repented and had no intention of repeating their misdeeds: "They came into court with a contrite heart and with the intention to forget and forgive if the Government would meet them half way." (American Safety Table Co. v. Singer Sewing Machine Co. (1938) 95 F.2d 543, 553.)

[2]Of course, there are circumstances in which any opportunity to repeat past violations is so remote that summary judgment may be proper. For example, in SEC v. Penn Central Co. (D. Pa. 1976) 425 F. Supp. 593, a defendant who was partially paralyzed by an acute stroke and who suffered other serious physical disabilities was granted summary judgment. The precarious state of his health made his re-entry into the securities field too remote, as a matter of law, to warrant the issuance of an injunction against him.

triable issues. The nature and extent of the culpability of the several defendants are material. Assessing the likelihood of recurrent violations of the securities laws requires a prediction of future conduct, and that, in turn, requires the court to probe the defendants' states of mind. Two facts are critical to this inquiry: "the character of past violations" and "the bona fides of the expressed intent to comply." (*United States v. W. T. Grant Co., supra,* 345 U.S. at 633. *See also SEC v. National Student Marketing Corp.* (D. D.C. 1973) 360 F. Supp. 284, 297.) As Professor Loss points out: "The ultimate test is whether the defendant's past conduct indicates—under all of the circumstances and not merely in view of the time which has elapsed since the last violation—that there is a reasonable likelihood of further violations in the future." (3 Loss, *Securities Regulation* (2d ed. 1961) at 1976.)

Neither the character of a defendant's past violations nor the bona fides of an expressed intent to comply can be ascertained without determination of the acts and conduct of each of these defendants in connection with the securities violations. An admission that illegal acts occurred for which someone had responsibility, perhaps a little bit of which might be attributed to a particular defendant, provides no clue to any defendant's state of mind for use as a predictor of his future conduct. An exploration of the nature and quality of the conduct of each defendant cannot be avoided by "admissions" that violations occurred for which responsibility need not be allocated.

One or more of these defendants was responsible for gross fraud, for diversion of corporate funds, and for active cover-up of the misdeeds. The allocation of responsibility depends heavily upon the credibility of the testimony of the several defendants. The courts have long recognized that summary judgment is singularly inappropriate where credibility is at issue. Only after an evidentiary hearing or a full trial can these credibility issues be appropriately resolved. (*See, e.g., Poller v. Columbia Broadcasting System, Inc.* (1962) 368 U.S. 464, 473; *United States v. Perry* (9th Cir. 1970) 431 F.2d 1020, 1022; 10 C. Wright & A. Miller, *Federal Practice and Procedure* § 2726 (1973). *Accord:* Note of the Advisory Committee on Amended Rule 56 ("Where an issue as to a material fact cannot be resolved without observation of the demeanor of witnesses in order to evaluate their credibility, summary judgment is not appropriate."); 31 F.R.D. 648 (1963).)

The general rule proscribing summary judgment where credibility is in question is particularly pertinent here. Defendants assert that they are now reformed and will never violate the securities laws again. The promises of defendants to obey the law and not to re-enter the securities market are, of course, expressions of the defendants' states of mind and are relevant to a determination of the likelihood of repetition. These statements are, however, necessarily self-serving and highly dependent on the credibility of the individuals making the statements. The fact that illegal conduct ceased provides no fur-

ther support for defendants' assurances that injunctive relief is unnecessary where the acts of contrition and process of reformation did not begin until the defendants must have realized that the accounts receivable scandal could no longer be kept hidden. (*Cf. United States v. Parke, Davis & Co., supra,* 362 U.S. 29, 48.) On this record, the district court could not decide that these defendants, or any of them, would not be recidivists.[3]

II

Summary judgment in favor of Andersen arose in a different context. Both the SEC and Andersen filed motions for summary judgment, each contending that it was entitled to judgment and that there were no genuine issues of fact. The SEC charged Andersen with simple negligence in the pre-August, 1973, period by reason of its failure to uncover the receivables fraud and with willful failure to disclose to the public the details of the KCI receivables fraud during the post-August, 1973, period, during the course of Andersen's special investigation.

The facts surrounding Andersen's audits of Koracorp's financial statements in the years 1970 through 1972, its special investigation in 1973, and its 1974 audit work on Koracorp's restated 1972 financial statement are not controverted. Andersen's statement

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[3]We, of course, express no views on the ultimate merits of the case. Nothing we have said should be read as implying a direction to the district court about the appropriate balancing of equities in the issuance or refusal to issue an injunction once the factual issues in dispute have been resolved.

of facts on its motion for summary judgment was adopted by the SEC in its brief in support of its own motion before the district court. The SEC's statement of undisputed facts was likewise not controverted by Andersen.

Upon the basis of these facts, Andersen, solely for the purpose of summary judgment, conceded that the firm's failure to uncover the receivables fraud was due to simple negligence. The SEC accepted that concession as to Andersen's pre-August, 1973, activities. The SEC, however, also claimed that Andersen was guilty of willful failure to disclose to the public details of the KCI receivables fraud during the period from August, 1973, to February 28, 1974.

We first address the question whether Andersen's failure to disclose to the public its findings as it pursued its special investigation was a violation of the federal securities laws. It is uncontested that Andersen along with Koracorp informed the New York and Pacific Coast Stock Exchanges and the SEC of the overbooking of accounts receivable on August 8. Although Andersen had not completed its special investigation in September, Andersen advised the SEC that it was withdrawing its consent to the use of its prior auditor's report in connection with Koracorp's 1972 financial statement, and it confirmed its understanding that Koracorp would "notify the Securities and Exchange Commission forthwith and . . . promptly make appropriate disclosure to the public and to the New York Stock Exchange." In the interim, the SEC had suspended all trading in

Koracorp's securities. Commencing in October, 1973, the SEC began its own extensive investigation of the Koracorp problems. The SEC deposed all of the key Andersen personnel involved in the Koracorp audits, obtained production of documents, including Andersen's work papers, memoranda, correspondence, and reports relating to those audits. Andersen and its personnel voluntarily cooperated with the SEC's investigation both as to document production and deposition testimony.

The SEC's argument that Andersen violated some kind of duty in reporting its findings during its special investigation is hard to follow. As nearly as we can ascertain, its claim of misconduct rests upon a contention that, in Andersen's September 10, 1973, letter to Koracorp and the SEC, withdrawing its consent to the use of its report on Koracorp's 1976 financial statement, Andersen was too cautious in its language. The Andersen letter stated that the information it had obtained "indicates the possibility that the consolidated financial statements of Koracorp Industries, Inc. for the year ended December 29, 1972, may require adjustments," and that "significant amounts of accounts receivable of that subsidiary (KCI) may have been included in these financial statements erroneously. . . ." The SEC argues that Andersen was engaged in a cover-up because it did not then and there state that "egregious management fraud had occurred." The SEC cites no authority and we have found none that poses a duty upon an accountant in the middle of a special investigation

to make a public announcement that the company whose affairs it is investigating is guilty of fraud. There was nothing in the record before the district court which permitted an inference that, under the circumstances of this case, Andersen was guilty of any kind of concealment. Moreover, there is nothing in the record suggesting that the alleged failure to disclose was material to investors. The fact of fraud had been revealed, even if it was not presented in language that the SEC might have chosen. Trading in Koracorp had been suspended for a month preceding Andersen's letter and remained suspended for another five months.

The only other fact to which the SEC points to support its contention that Andersen was guilty of a kind of culpable non-disclosure is that Andersen's February 28, 1974, report on Koracorp's restated 1972 financial statement said that "sufficient information is not available at present to determine the amount of the adjustment relating to this discontinued operation which may be applicable to periods prior to 1972." But the SEC points to nothing that casts any doubt about the accuracy of that statement. The SEC argues that the statement was misleading because it did not also tell investors either how or why the KCI receivables were improperly booked. Perhaps there may be situations in which a failure to report results of an ongoing investigation in greater detail may be misleading, but the record in this case does not support the inferences that the SEC asks us to draw. The SEC has not given us any reason why

there was a substantial likelihood that a reasonable shareholder in 1974 would consider the omitted details of any significance. (*See TSC Industries, Inc. v. Northway, Inc.* (1976) 426 U.S. 438, 448-49.) By 1974, Andersen had already audited Koracorp's year-end 1973 report, trading in Koracorp had been suspended, and there had been substantial public disclosure with respect to the KCI scandal.

We are left then with the SEC's claim that Andersen's failure to detect the overbooking scheme before August, 1973, constituted simple negligence for which injunctive relief would be appropriate.[4]

Unlike the Koracorp and KCI defendants, Andersen's conduct in these transactions was fully exposed, and its state of mind was not in issue. No triable issue of fact remained, as both the SEC and Andersen agreed below. The record thus presented to the district court on the cross-motion for summary judgment the issues: (1) Is injunctive relief under Section 10(b) and Rule 10b-5 available to the SEC against an independent auditor who was guilty of simple negligence, and (2) if the relief is available, did the district court abuse its discretion in refusing to grant injunctive relief?

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[4]The SEC also argues on appeal that Andersen's failure to uncover the fraud was reckless. That contention, however, was not made before the district court, and we, therefore, decline to consider it on appeal. Reliance upon simple negligence, of course, was understandable because at the time the issue was presented to the district court, no shadow had been cast upon White v. Abrams (9th Cir. 1974) 495 F.2d 724, holding that, even in private actions, negligence could be a basis for liability.

We need not reach the first question, which was specifically left open in *Ernst & Ernst v. Hochfelder* (1976) 425 U.S. 185, 194 n.12, on this appeal because, even if we assume that simple negligence is enough to sustain the SEC's suit for an injunction, the district court was nevertheless free to exercise its discretion in denying equitable relief against Andersen. No *per se* rule requiring the issuance of an injunction upon the showing of past violation exists. (*SEC v. Bausch & Lomb, Inc.* (2d Cir. 1977) 565 F.2d 8, 18; *SEC* v. *Management Dynamics, Inc.* (2d Cir. 1975) 515 F.2d 801, 807.) The critical issue is whether there is a reasonable likelihood that the wrong would be repeated. The district court has a significant degree of latitude in making that determination. "[T]he court always is free to direct the entry of summary judgment for defendant where there are no genuine issues of material fact and the court is unwilling to award plaintiff discretionary relief." (10 C. Wright & A. Miller, *Federal Practice and Procedure, supra,* § 2731, at p. 605.) The SEC has failed to show that the district court abused the discretion accorded it. (*SEC v. Bausch & Lomb, Inc., supra,* 565 F.2d at 18.) Although we might have reached a different conclusion if we were sitting as a district court, we cannot say that the district court abused its discretion in declining to issue an injunction against Andersen.[5]

Judgment in favor of Andersen is affirmed. The judgments in favor of the remaining defendants are

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[5]Nothing we have said suggests that we have expressed any view upon the liability, if any, of Andersen predicated upon common law liability for negligence.

reversed and the causes are remanded to the district court for further proceedings consistent with the views herein expressed.

JAMES M. CARTER, Circuit Judge, concurring:

I am disturbed by the fact that the majority sends this case back for evidentiary hearings to a busy district court (the Northern District of California at San Francisco) apparently to find specifically the extent of each individual defendant's bad conduct and what his responsibility was in the overall picture. An evidentiary hearing to ascertain the various misdeeds and responsibility of each defendant in connection therewith could well require months of a district court's time. The same issues are present in civil actions pending against these defendants. In some way extensive evidentiary hearings in this case ought to be avoidable on remand to the district court.

The record shows that the individual defendants made admissions that violations occurred, but did not take any responsibility for particular violations (see majority opinion, *supra,* page 9, lines 28 to 32 of the typewritten opinion). In view of the pending civil suits against these defendants it is understandable that they are unwilling to make further admissions as to their complicity in the overall scheme. However, perhaps they could make more specific admissions for the purpose of this motion only. Or perhaps the district judge on his own could explicitly assume that the charges by the S.E.C. against each defendant were proven. I think that if the individual defendants

admitted for the purposes of this motion only, or if the district judge assumed as proven, the specific charges as set forth in the majority opinion (page 4, lines 19 to 30), then there would no longer be a genuine issue as to any material fact. Summary judgment could then be entered without need of a long evidentiary hearing.

Appendix C

STATUTES, REGULATIONS AND RULES

SECURITIES ACT OF 1933

Section 17(a):*

SECTION 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 20(b):**

(b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation prescribed under authority thereof, it may in its discretion bring an action in any district court of the United States, United States court of any Territory, or the United States District Court for the District of Columbia to enjoin such acts or practices, and upon a proper showing a perma-

*15 U.S.C. 77q(a).
**15 U.S.C. 77t(b).

nent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this title. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of begins, or in the district wherein such prospectus or security is received.

Section 22(a):*

(a) The district courts of the United States, and the United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any

*15 U.S.C. 77v(a).

proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.

SECURITIES EXCHANGE ACT OF 1934

Section 10(b):*

SECTION 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 13(a):**

SECTION 13. (a) Every issuer of a security registered pursuant to section 12 of this title shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security—

(1) such information and documents (and such copies thereof) as the Commission shall require to keep reasonably current the information and documents required to be included in or filed with an application or registration

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*15 U.S.C. 78j(b).

**15 U.S.C. 78m(a).

statement filed pursuant to section 12, except that the Commission may not require the filing of any material contract wholly executed before July 1, 1962.

(2) such annual reports (and such copies thereof), certified it required by the rules and regulations of the Commission by independent public accountants, and such quarterly reports (and such copies thereof), as the Commission may prescribe.

Every issuer of a security registered on a national securities exchange shall also file a duplicate original of such information, documents, and reports with the exchange.

Section 21(d):*

(d) Wherever it shall appear to the Commission that any person is engaged or is about to engage in any acts or practices constituting a violation of any provision of this title, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, or the rules of the Municipal Securities Rulemaking Board, it may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted

*15 U.S.C. 78u(d).

without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this title or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title.

Section 21(e):*

(e) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

Section 27:**

The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and reg-

*15 U.S.C. 78u(e).
**15 U.S.C. 78aa.

ulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

RULES UNDER THE SECURITIES EXCHANGE ACT OF 1934

Section 10b-5:*

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

*17 CFR 240.10b-5.

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Rule 13a-1:*

Every issuer having securities registered pursuant to Section 12 of the Act shall file an annual report on the appropriate form authorized or prescribed therefor for each fiscal year after the last full fiscal year for which financial statements were filed in its registration statement. Registrants on Form 8-B shall file an annual report for each fiscal year beginning on or after the date as of which the succession occurred. Annual reports shall be filed within the period specified in the appropriate form. At the time of filing the annual report, a registrant other than a person registered under the Public Utility Holding Company Act of 1935 or the Investment Company Act of 1940 shall pay to the Commission a fee of $250, no part of which shall be refunded.

Rule 13a-13(a):**

(a) Except as provided in paragraph (b), every issuer which has securities registered pursuant to Section 12 of the Act and which is required to file annual reports pursuant to Section 13 of the Act on Form 10-K, 12-K or U5S shall file a quarterly report on Form 10-Q, within the period specified in General Instruction A to that form, for each of the first three fiscal quarters of each fiscal year of the issuer, commencing with the first such fiscal quarter which ends after securities of the issuer become so registered.

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*17 CFR 240.13a-1.

**17 CFR 240.13a-13.

Rule 56(c):

(c) MOTION AND PROCEEDINGS THEREON. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

Nos. 77-1859 and 78-295

In the Supreme Court of the United States

OCTOBER TERM, 1978

JERE N. HELFAT, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

KORACORP INDUSTRIES, INC., ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 4-23)[1] is reported at 575 F. 2d 692. The opinion of the district court (Pet. App. 1-3) is not officially reported.

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[1]"Pet. App." references denote the appendix in No. 77-1859.

JURISDICTION

The judgment of the court of appeals was entered on February 6, 1978. Rehearing was denied on May 24, 1978. The petitions for a writ of certiorari were filed on June 29, 1978 (No. 77-1859) and August 22, 1978 (No. 78-295). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, in an action to enjoin petitioners and others from future violations of the securities laws, the extent of petitioners' involvement in an admittedly fraudulent scheme is a "material fact" that, when disputed, precludes summary judgment in petitioners' favor under Fed. R. Civ. P. 56(c).

STATEMENT

Petitioners in No. 78-295 are Koracorp Industries, Inc. ("Koracorp"), a corporation whose common stock is traded on the New York Stock Exchange and the Pacific Coast Exchange, and Koratec Communications, Inc. ("KCI"), Koracorp's wholly-owned subsidiary. Petitioner in No. 77-1859 is Jere N. Helfat, who was the chief executive officer and president of Koracorp.

The Securities and Exchange Commission brought this action against petitioners and others[2] in the United States District Court for the Northern District of California,

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[2]The Commission also named as defendants in this action Arthur Andersen & Co., Koracorp's independent auditor; Arthur Cunningham, vice-president and a director of Koracorp; Phillip Weil, president of KCI; and a group of corporations (Western Gateway Corporation, Verve, Inc., Associated Graphics, Inc., and Allison Production Affiliates, Inc.) that Weil controlled.

alleging violations of antifraud[3] and reporting[4] provisions of the federal securities laws and seeking to enjoin each of the defendants from further violations of these provisions.

It is undisputed that KCI improperly inflated its accounts receivable in 1970, 1971 and 1972. Because KCI's financial statements were consolidated with those of Koracorp, the latter's reported income for 1972 had to be decreased by more than $5 million when the fraud was discovered. As a result, Koracorp's revised statement of earnings showed a loss of $1.02 per share for that year, instead of a profit, as originally reported (Pet. App. 5-7).

Evidence presented by the Commission indicated that the principal architect of this fraud was defendant Phillip Weil, the president of KCI from 1971 through August 3, 1973 (Pet. App. 5). Weil's compensation at KCI was, for a period, tied to the amount of business the company did; the SEC charged that, in order to increase his compensation, Weil caused to be placed and carried on KCI's books millions of dollars in spurious receivables (*ibid.*).

The SEC sought relief against petitioner Helfat (and other defendants) because they appeared either to have been active participants in Weil's scheme or to have closed their eyes to clear evidence of his fraud prior to the public exposure of his scheme, and they thus failed in their duty to the corporation's stockholders (Pet. App. 8). For example, Arthur Andersen & Co., Koracorp's auditors, had in 1970, 1971 and 1972 informed petitioner Helfat of the

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[3]Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5.

[4]Section 13(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78m(a), and Rules 13a-1 and 13a-13 thereunder, 17 C.F.R. 240.13a-1, and 240.13a-13.

unsatisfactory records and internal controls of KCI. On more than one occasion, changes were purportedly instituted in the manner that accounts receivable were recorded, contracts administered, and reserves set up for long past-due receivables (Pet. App. 6). But, in fact, petitioner Helfat never took the steps necessary to correct the receivables problem; none of the new policies was complied with, and the lax internal controls at KCI persisted.[5]

On May 3, 1973, the day before scheduled meetings of Koracorp's board of directors and stockholders, the accounts receivable problem was again brought to the attention of petitioner Helfat.[6] Although the board of directors of Koracorp was informed of the KCI receivables problem at that time, Helfat decided not to inform the corporation's shareholders of the company's problems; he instead assigned Koracorp's controller to investigate. No substantial action was taken until August 1973, when Arthur Andersen & Co. was directed to conduct a special investigation of the KCI situation.[7]

At a special meeting of the board of directors on August 7, 1973, Weil resigned as president of KCI (Pet. App. 7). After this meeting, Koracorp finally informed the New York Stock Exchange and the Pacific Coast Stock

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[5]Gourley Aff. B, Ex. 2 (R. 1143).

[6]Postyn Tr. (October 10, 1973) 20.

[7]Weil Tr. (April 25, 1974) 215. The controller did not begin his investigation until June 13, 1973, but by the end of June he was sufficiently concerned to request that Helfat call a meeting at which Weil would be required to explain in detail the situation with respect to KCI receivables. Helfat delayed calling this meeting until early August 1973. Kittleberger Tr. (October 10, 1973) 13, 16, 18; Helfat Tr. (December 4, 1973) 114.

Exchange of the KCI problem. The Commission was also informed, and, on August 8, 1973, it suspended all trading in Koracorp securities (*ibid.*), in order to allow sufficient time for Koracorp to provide shareholders with all material information concerning the KCI receivables fraud and its effect on Koracorp's financial statements.

At a meeting of the board of directors on August 24, 1973, Helfat was requested by the board to resign as president and a director of Koracorp; he was retained, however, as a special consultant to the company at his full salary of $95,000 per year, plus all fringe benefits. In addition, Koracorp's vice-president (and director) Cunningham was asked to resign and, after having refused to do so, was removed by board resolution from his position as a corporate officer (Pet. App. 8).

When the SEC brought this action to enjoin petitioners and others from future violations, petitioners (and other defendants) moved for summary judgment. Without attempting to determine the degree of responsibility of each of the defendants for what had occurred, the district court granted the motions of all defendants for summary judgment. The court accepted the defendants' suggestion "that the nature of the defendants' activities in connection with the violations was not significant in deciding whether injunctions should issue" and "accordingly restricted the inquiry into the conduct of the parties after the exposure of the fraud in August 1973" (Pet. App. 9). Limiting its consideration to the defendants' conduct after the principal violations alleged by the Commission had occurred, the district court concluded that "[t]here is no showing whatsoever of any violations by these parties in the last 18 months, and no facts have been alleged upon which the court could conclude that there is any expectation of further violations" (Pet. App. 2).

The court of appeals reversed the district court's grant of summary judgment in favor of petitioners.[8] It held that the central issue is "whether as a matter of law the district court could conclude that 'there was no significant threat of future violation"; and, the court held, "the nature and extent of the culpability of the several defendants is a material fact" in that determination—a disputed fact that could not be determined on a motion for summary judgment (Pet. App. 11).

ARGUMENT

The decision of the court of appeals is correct and raises no issue warranting review by this Court. There is no conflict with prior decisions of this Court, and petitioners do not suggest that there is a conflict among appellate decisions. The case involves no more than the application of acknowledged principles to particular facts.

Petitioners contend that there is no disputed issue of material fact because the issue on which the parties concededly disagree—the extent to which the various defendants participated in the violations of law—is not material to the question whether injunctive relief should be awarded. All sides agreed that the evidence of participation by the various defendants would be in sharp conflict if introduced (Pet. App. 10); thus the question that controls the propriety of summary judgment is whether the extent to which individual defendants violated the law in the past is material to the question whether they are likely to continue to violate the law in the future and thus should be subject to restraint. The court of appeals held that the extent of past participation

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[8]The court of appeals affirmed summary judgment in favor of Arthur Anderson & Co. (Pet. App. 16-22). That ruling is not before this Court.

is indeed material. In the court's words: "Assessing the likelihood of recurrent violations of the securities laws requires a prediction of future conduct and that, in turn, requires the court to probe the defendants' states of mind. Two facts are critical to this inquiry: 'the character of past violations' and 'the bona fides of the expressed intent to comply.' (*United States* v. *W.T. Grant Co.* [345 U.S. 629 (1953)] * * *.)" (Pet. App. 14). The court then reasoned that "[n]either the character of a defendant's past violations nor the bona fides of an expressed intent to comply can be ascertained without determination of the acts and conduct of each of these defendants in connection with the securities violations." *Ibid.* The court is clearly right. A district court cannot intellegently exercise its ample discretion to shape relief until it knows what each defendant did and can separate the knaves from the negligent.

Petitioners argue, however, that the decision of the court of appeals is contrary to *United States* v. *W. T. Grant Co.*, 345 U.S. 629 (1953), and *Hecht Co.* v. *Bowles*, 321 U.S. 321 (1944). But those cases did not hold, as petitioners suggest (Helfat Pet. 9-12; Koracorp Pet. 9-12), that the nature of past acts or predictions of future ones are irrelevant on motions for summary judgment. The question was not presented in those cases, for they involved no dispute about the underlying facts.

In *W. T. Grant* the individual defendant had served on the boards of directors of three pairs of corporate defendants alleged to be in competition. The defendants filed affidavits stating that "the interlocks no longer existed * * *" and disclaiming "any intention to revive them" (345 U.S. at 633). The government conceded "the truth of the defendant's affidavits * * *" (*id.* at 635) and did not itself seek to introduce any conflicting evidence. As this Court pointed out, "In these circum-

stances, the District Judge could decide that there was no significant threat of future violation and that there was no factual dispute about the existence of such a threat." *Ibid.*

In *Hecht Co.*, which involved the question whether the district court was *required to* issue an injunction once a violation of the Emergency Price Control Act was shown, this Court similarly found that there was "no substantial controversy as to the facts," 321 U.S. at 324, and that the district court had "concluded that the mistakes * * * were all made in good faith and without intention to violate the regulations." *Id.* at 325.

In contrast to those cases, many of the circumstances concerning the activities of the defendants in this case are still unknown. What is known, as the court of appeals noted, is that "[o]ne or more of these defendants was responsible for gross fraud, for diversion of corporate funds, and for active cover-up of the misdeeds" (Pet. App. 15). In this Court petitioners, as all the defendants did in the courts below, contend that, whatever the scope of the fraud, the finger should be pointed at some other defendant—each asserts that his own culpability is minimal or irrelevant (Koracorp Pet. 6; Helfat Pet. 14-15). Contrary to petitioner Helfat's assertion (Pet. 13), the court of appeals did not, of course, decide who was properly subject to injunction and who was not (see Pet. App. 16 n.3). It merely found that, on this record, the district court could not properly make a blanket finding that no defendant should be enjoined. It may well be that, after further hearings, the district court will come to that conclusion. But to reach that decision it cannot rely on " 'admissions' that violations occurred for which responsibility need not be allocated" (Pet. App. 14). Rather it must "explor[e] * * * the nature and quality

of the conduct of each defendant * * *" (*ibid.*).[9] Until that task is done, petitioner Helfat's request that this Court decide whether injunctive relief is proper for merely negligent violations of the securities laws (Pet. 19-30) is premature.

Petitioners' argument (Koracorp Pet. 17-19; Helfat Pet. 12) that the court of appeals erred in holding that "the district court improperly allocated the burden of persuasion on motion for summary judgment" (Pet. App. 9) is incorrect. Under Fed. R. Civ. P. 56(c), the district court's first task in ruling on a motion for summary judgment is to determine whether any genuine issue of material fact exists. *United States* v. *Diebold, Inc.*, 369 U.S. 654, 655 (1962); *Radobenko* v. *Automated Equipment Corp.*, 520 F. 2d 540, 543 (9th Cir. 1975). When material facts are in dispute, they may not be resolved on motion for summary judgment. Accordingly the court of appeals correctly concluded that the parties moving for summary judgment must "clearly * * * establish the nonexistence of any genuine issue of fact material to judgment in their favor" and that "all factual inferences are to be taken against the moving party and in favor of the opposing party" (Pet. App. 11, 12). See *Radobenko* v. *Automated Equipment Corp., supra,* 520 F. 2d at 543; *Caplan* v. *Roberts,* 506 F. 2d 1039, 1042 (9th Cir. 1974).

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[9]Petitioner Koracorp's argument (Pet. 12-17) that the court of appeals applied an incorrect standard of review under *W. T. Grant Co.* in reversing the district court, and petitioner Helfat's contention (Pet. 17-19) that the court applied to him a standard inconsistent with that it applied to Arthur Andersen, are insubstantial. *W. T. Grant* required a showing of abuse of the district court's discretion (345 U.S. at 629-630), and that is the standard the court of appeals applied here to Arthur Anderson's case (Pet. App. 9, 21) once it found that no material facts concerning that defendant were in dispute. Because it found that there is a dispute of material fact concerning petitioners, the court of appeals had no occasion to reach the question whether the district court abused its discretion (Pet. App. 9).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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